

CITY AUDITOR'S OFFICE

Real Property Leases and Licenses

FEBRUARY 5, 2010

AUDIT REPORT NO. 1008

CITY COUNCIL

Mayor W.J. "Jim" Lane Vice Mayor Lisa Borowsky Wayne Ecton Suzanne Klapp Robert Littlefield Ron McCullagh Tony Nelssen



February 5, 2010

Honorable Mayor and Members of the City Council:

Enclosed is a report on Real Property Leases and Licenses, Audit No. 1008, which reviewed the identification and tracking of City-owned real property leases and evaluated these agreements that generate revenue.

In general, the City's real property agreements are managed by various Contract Administrators throughout the City, which can create challenges when seeking Citywide information related to leases and licenses. At least two previous audits have recommended a centralized database to facilitate tracking these agreements and providing access to complete real property lease and license information.

The most significant area for improvement continues to be the need for centralized, complete information related to real property agreements and the related accounts receivable. Despite an Administrative Regulation requiring it, the current Real Property Lease and License database information is neither complete nor comprehensive. In addition, the related accounts receivable are often not recorded in the City's accounts receivable billing system.

If you need additional information or have any questions, please contact me at (480) 312-7867.

Sincerely,

. Sharron Walker, CPA, CFE

Tharron Waller

City Auditor

Audit Team:

Lisa Gurtler, Assistant City Auditor Kim Prendergast, Senior Auditor

TABLE OF CONTENTS

Execu	tive Summary	_ .1
Backg	round	. 2
Object	tives, Scope, And Methodology	. 4
Findin	gs and Analysis	. 5
1.	Centralized Real Property Database information is not complete	. 5
2. Iimi	Asset Management oversight of real property lease and license agreements is ted	
3.	Accounts receivable related to real property leases and licenses are not sistently recorded.	
4.	Maintaining two Citywide databases to record City contracts is inefficient	. 7
Mange	ement Response	.9
Action	Plan2	LO

EXECUTIVE SUMMARY

An audit of Real Property Leases and Licenses was included on the City Council-approved fiscal year 2009/10 audit plan. This audit reviewed the identification and tracking of real property leases and evaluated the agreements that generate revenue. The scope included City-owned real property leases and licenses with terms longer than one year that were effective in fiscal years 2008/09 and 2009/10. These agreements are estimated to generate \$4.7 million in fiscal year 2009/10.

Administrative Regulation 387, Centralized Reporting of Real Property Leases/Licenses with Terms Longer than One Year, requires that a Citywide database be developed and maintained by Asset Management staff, part of the Public Works & Water Resources Division. Additionally, Asset Management staff is responsible for the development of real property agreements and acquisition and disposal of real property for the City.

In reviewing the City's real property leases and licenses, we found that they are managed by various Contract Administrators throughout the City. This can create challenges when seeking Citywide information related to these leases and licenses and ensuring all accounts receivable have been collected. The following areas were noted where improvements can be made:

- The centralized Real Property Database information is not complete and the database does not include all relevant agreements.
- Asset Management involvement in development of real property lease and license agreements is limited. Other departments typically develop their own agreements independently.
- Accounts Receivable related to real property leases and licenses are often not recorded in the City's accounts receivable billing system. Approximately 14% of the related agreements, or \$658,000, have automated billings generated and related Receivables aging reports.
- Currently two related Citywide databases are maintained to record certain types of City contracts. Combining these databases into one more comprehensive database would be more efficient and would likely be easier to monitor and maintain.

BACKGROUND

The City regularly enters into real property lease and license agreements to allow third parties to use City-owned land or land in which the City holds an interest. *Real property* is defined as land, buildings and other immovable improvements placed on the land. A *lease* creates an ownership interest in the real property. Examples of leases include the City's long term golf course agreements: Sanctuary, Silverado, and Tournament Players Club. In contrast, a *license* grants permission to use property, but does not convey ownership interest. Common licenses include telecommunications towers placed on City land or outdoor dining facilities in the City's right-of-way. The term "real property licenses" can be construed to cover a range of agreements from concessionaire services at the Scottsdale Stadium to rented use of City facilities at WestWorld or a City park.

Some lease and license agreements are awarded through Requests for Proposals (RFPs) with businesses competitively bidding to use City property to provide services to customers, such as car rental company proposals to operate at the Scottsdale Airport. Other noncompetitive agreements, such as placement of telecommunications towers or outdoor dining agreements, are evaluated administratively by staff. Per Scottsdale Revised Code, all lease and license agreements with terms greater than one year require City Council approval, regardless of the method used to develop the agreement.

Real Property Lease and License Revenue

Revenues generated by real property agreements totaled approximately \$9.6 million in fiscal year 2008/09 and are estimated to be \$9.7 million during fiscal year 2009/10. However, this audit focuses on the real property lease and license agreements identified as having a term of greater than one year. Revenue generated from these agreements is budgeted at \$4.7 million in fiscal year 2009/10, as reflected in Table 1.

Table 1: Real Property Lease & License Revenue Agreements with Terms Exceeding One Year

Contract Administration	Description	FY 08/09 Actual	FY 09/10 Budget	% Budget FY 09/10
Parks & Recreation	Scottsdale Princess Dev Agreement	\$1,339,842	\$1,403,804	30%
Parks & Recreation	TPC Golf Course	915,339	954,149	20%
Parks & Recreation	Stadium Usage Fee	434,119	423,869	9%
Parks & Recreation	Inlet Silverado Golf Surcharge/Fee	109,798	104,000	2%
Parks & Recreation	Sanctuary Golf Course/Surcharge	133,309	52,129	1%
	Total Community Services	\$2,932,407	\$2,937,951	63%
Airport	Airport Leases, Restaurant, Hangar	1,071,739	1,033,586	22%
	Total Economic Vitality	\$1,071,739	\$1,033,586	22%
Plan Nghbrhd & Trans	Right-of-Way Fees	434,091	349,646	7%
Public Works/Water Res	Land & Bldg Rent/Comm Arts Trust	88,536	150,000	3%
Public Works/Water Res	Rent Adm - Water/Harquahala Valley Dist	169,921	150,000	3%
Public Works/Water Res	Land / Bldg Rent - Asset Mgmt	35,330	44,913	1%
	Total Public Works & Water Resources	\$727,878	\$694,559	15%
	Total Revenue	\$4,732,024	\$4,666,096	100%

SOURCE: Auditor analysis of City-prepared financial reports, fiscal years 2008/09 through 2009/10.

Page 2 Audit Report No. 1008

Real Property Administration

As depicted in Table 1, administration of real property lease and license agreements is decentralized throughout the City. Contract Administrators in the Parks & Recreation department of the Community Services Division administer agreements generating 63% of the fiscal year 2009/10 budgeted revenues. The Airport, with 22% of the budgeted revenue, is administered by Economic Vitality Division staff. All other agreements, which account for 15% of budgeted revenues, are administered or provided oversight by Asset Management staff within the Public Works & Water Resources Division. Although Asset Management staff administers the smallest revenue percentage of lease and license agreements, they are responsible for maintaining the City's centralized Real Property Database. This responsibility is assigned by Administrative Regulation (AR) 387, Centralized Reporting of Real Property Leases/Licenses with Terms Longer than One Year.

The Asset Management program, located within the Capital Projects Management (CPM) department of the Public Works & Water Resources Division, consists of two staff members: an Asset Management Coordinator and a Real Estate Management Specialist. In addition to maintaining the centralized Real Property Database, staff is responsible for development of real property agreements and acquisition and disposal of real property rights for the City.

The City Auditor's Office previously issued two audit reports, one in 1996 and one in 2005, related to real property leases and licenses. Both of these audit reports identified the need for a centralized comprehensive inventory of real property agreements. While staff has developed a well structured database to record these agreements, some of the information is incomplete or outdated.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives for this audit were to review the identification and tracking of real property leases and licenses and to evaluate these agreements that generate revenue. The scope of the audit included City-owned real property leases and licenses with terms longer than one year that were effective in fiscal years 2008/09 and 2009/10.

Methodologies used to obtain evidence addressing the audit objectives and to provide a reasonable basis for findings and conclusions included:

- Reviewing City Charter and Scottsdale Revised Code related to real property leases and licenses.
- Meeting with City staff from Public Works & Water Resources, Community Services, Finance and Accounting, Purchasing, and the City Attorney's Office to gain an understanding of their current processes and the applicable requirements.
- Reviewing real property lease and license agreements to identify:
 - General terms, such as payment amount, expiration date and method of procurement
 - Telecommunication license agreements, to ensure they were not issued for more than 5 years, in compliance with City Code
 - Right-of-way agreements, to ensure they were issued to entities with an adjacent property interest, in compliance with City Code
- Reviewing SmartStream financial reports to identify real property lease and license general ledger accounts and analyze revenue trends.
- Reviewing accuracy and completeness of information in the Real Property Database developed by Asset Management staff and evaluating possible enhancements to the database.
- Comparing data contained in the Real Property Database with the Contract Tracking Database developed by the Division of Finance and Accounting to evaluate completeness of information and duplication of effort.

We found that real property agreements are managed by various Contract Administrators throughout the City. This can create challenges when seeking Citywide information related to leases and licenses and for ensuring all related accounts receivable have been collected. We found the Real Property Database contained comprehensive and useful data fields, such as links to the agreements, descriptions of real property locations, and payment information. However, areas for improvement, which include maintaining a more complete, comprehensive database for real property agreements, are described further in the Findings and Analysis section of this report.

We conducted this audit in accordance with generally accepted government auditing standards as required by Article III, Scottsdale Revised Code, Section 2-117, et seq. Generally accepted government auditing standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Audit work took place from November 2009 through December 2009, with Lisa Gurtler and Kim Prendergast conducting the work.

Page 4 Audit Report No. 1008

FINDINGS AND ANALYSIS

1. Centralized Real Property Database information is not complete.

Administrative Regulation (AR) 387, Centralized Reporting of Real Property Leases/Licenses with Terms Longer than One Year, states that staff from all departments that administer real property related lease or license agreements will enter data into a common database maintained by Asset Management. A data entry form is required to be available for department staff to use, and the data is required to be updated semiannually.

As of December 2009, the centralized Real Property Database contained 260 lease and license agreements. When testing 40 agreements included in the database, we found:

- none identified the Contract Administrator or Department/Division responsible for managing the agreement, or the Council Action Report number or approval date,
- 23 did not include insurance information or an indication insurance was not applicable,
- 21 did not include payment information or an indication payment was not applicable,
- 18 did not include a contract number.
- 9 did not include sufficient information to identity the contracting parties, such as vendor contact name and phone number,
- 6 did not include the real property location, and
- 4 did not include the agreement's status (Active, Inactive, or Pending)

To determine completeness of the database, we reviewed Council Action Reports for two 6-month periods, January through June 2008 and July through December 2009. Of 19 real property related agreements identified in these two periods, 11 had not been entered into the database. In addition, a cursory review of the database revealed other agreements that were either not included or out-of-date, such as the SkySong agreement, the Scottsdale Stadium-Giants agreement, and commercial office space and land leases at the Scottsdale Airport. Further, we determined a data entry form for Contract Administrator use has not been developed.

According to management, limited staff availability and lack of software support have resulted in incomplete information in the database. As a result, the database has limited usefulness, and the City lacks a comprehensive central information point for monitoring and evaluating its real property licenses and leases.

Recommendations:

- Comply with AR 387 requirements to provide data entry forms for Contract Administrators to be able to comply with the requirement to update the database at least semiannually.
- Require Contract Administrators to complete all information fields in the database or note them as "Not Applicable."
- Monitor Council Action Reports to identify approved real property related agreements for inclusion in the database. Consider ensuring the agreement is in the database before related revenue is credited to the particular department.
- Meet with Information Technology management to determine the availability of database support.

2. Asset Management oversight of real property lease and license agreements is limited.

The Procurement Code states that real property transactions such as leasing and licensing are the responsibility of the Asset Management Office. Additionally, the Asset Management Coordinator job description and department policy state Asset Management staff is responsible for leading, assisting or consulting in work related to real property acquisition and management. This includes lease/license preparation and development of Request for Proposals (RFPs).

During testing, we found numerous real property lease and license agreements that were not overseen by Asset Management. However, these agreements appeared to be properly monitored by the assigned Contract Administrators who generally prepared and issued the agreements based on a RFP. Additionally, all agreements tested appeared to contain reasonable revenue terms. Of those we tested, one agreement had been procured without a RFP. Scottsdale Stadium staff explained that this concession services agreement has had the same vendor for approximately 17 years, largely because the vendor holds the liquor license¹ for this location and is contracted by the Giants for the four months they occupy the stadium. As with the other agreements, this concession agreement may have benefitted from competitive bidding. While the Procurement Code states the *purchase* of goods or services which exceed \$25,000 require invitations for bids or RFPs, a corresponding threshold does not exist for the revenue-generating lease and license agreements.

According to Public Works & Water Resource management, Asset Management staff is not always involved in certain lease and license agreements because of limited staff availability or because staff did not interpret the particular agreement to be real property-related.

Recommendations:

- Management should reevaluate and clarify the necessary level of Asset Management involvement to determine if these resources can be redirected. Applicable internal polices, Administrative Regulations, and the Procurement Code should be updated accordingly. In addition, guidance should include a comprehensive definition of what constitutes real property.
- Management should establish a threshold that would generally require RFPs to be issued for revenue-generating real property agreements.

Page 6 Audit Report No. 1008

¹ The Arizona Department of Liquor Licenses and Control (ADLLC) may issue multiple liquor licenses for one location, according to ADLLC staff. However, the ADLLC staff also noted that because only one license may be active at a time, vendors could find the limited-term coupled with the cost of acquiring the license to be prohibitive.

3. Accounts receivable related to real property leases and licenses are not consistently recorded.

Administrative Regulation 215 – *Contract Administration* requires Contract Administrators to manage, supervise, and monitor the terms, conditions, and specifications of contracts. Responsibilities include, but are not limited to, notifying Accounting of contract payment terms to ensure payments are received.

Currently, accounts receivable billings are set up for approximately 14% (or \$658,000) of the estimated \$4.7 million fiscal year 2009/10 real property lease and license revenues. Accounting staff generally become aware of real property lease and license revenues when lessee/licensee payments are deposited with the City Cashier. According to Finance and Accounting management, limited staff availability has delayed establishing comprehensive accounts receivable billings. As a result, automated billings and Accounts Receivable Aging Reports are not available to all Contract Administrators responsible for monitoring revenuegenerating agreements.

Recommendation: Finance and Accounting management should continue to work with Contract Administrators to record known accounts receivables.

4. Maintaining two Citywide databases to record City contracts is inefficient.

At least two City databases have been established to track information related to Citywide real property leases and leases.

- (1) The Real Property Database was developed by Asset Management staff approximately 4 years ago exclusively for real property related agreements with terms over one year as required by AR 387, Centralized Reporting of Real Property Leases/Licenses with Terms Longer than One Year. This database was established in response to a previous Auditor's report, Real Property Asset Management, Report No. 0407A. Required information includes, but is not limited to: links to agreements, contract name, contract start and end date, description of the real property location, insurance requirements and payment information. As of December 2009, this database included 260 active and inactive agreements, but many data elements were left blank for these agreements.
- (2) The **Contract Tracking Database** was developed by Finance and Accounting management approximately 3 years ago in response to a recognized need for centralized contract information. The database was intended to include all City contracts and be maintained by all Contract Administrators. This database is designed to include: contract name and number, contract start and end date, and department contact. As of December 2009, this database included 1,189 active and inactive contracts, but many data elements were left blank for these contracts.

Although the two databases contain some of the same information, both were incomplete. Based on interviews, it appears that Contract Administrators are not consistently familiar with the requirements to maintain either database and, therefore, have not consistently updated them. Developing one Citywide database with all desired data elements, with appropriate data entry forms and data quality controls, would be a more efficient method of maintaining City contract information. In addition, a single database would be a more

efficient method of making information more easily accessible for contract monitoring and decision making.

Recommendation: Management should evaluate the need for two similar databases and determine if a single database would be more efficient for Contract Administrators and Information Technology support staff. Additionally, management should put procedures in place to ensure the database is complete and accurately maintained.

Page 8 Audit Report No. 1008

MANGEMENT RESPONSE



Public Works and Water Resources 9191 E San Salvador Drive Scottsdale, AZ 85258 (480) 312-5555

Date: February 4, 2010

To: Sharron Walker, City Auditor

From: Dan Worth, Director of Public Works

Copy: David Richert, Acting City Manager

Subject: Management Response to Audit Report No. 1008

Real Property Leases and Licenses

I would like to express appreciation for the professional and diligent manner in which the preparation of the above referenced audit and report was conducted. The resulting analysis will provide Capital Project Management with the ability to better manage the real property leases and license data base.

We agree with the findings provided in the Audit Report. In the attached Management Response, we have detailed specifications that we will undertake over the next year, and the proposed timeframe to resolve the issues identified in the report. We are confident that these efforts will further improve the controls in place to ensure the City's interests are protected in its leasing and licensing program.

1. Centralized Real Property Database information is not complete.

MANAGEMENT RESPONSE: Management agrees that the Real Property Database information is not comprehensive. Asset Management staff created this database beginning in 2006 as a result of a recommendation from a previous audit. As staff gains experience in using the data to help manage the lease and license program, they continue to identify potential improvements in the content and structure of the database, and to better integrate the database into management processes.

PROPOSED RESOLUTION:

- Asset Management staff, with support from Information Technology staff, will
 continue to refine the existing online data entry forms to optimize their
 functionality. In addition, staff will consider the possibility of modifying the forms
 so that data fields that are not applicable to certain types of agreements do not
 appear.
- Public Works management currently monitors Council Action Reports to identify agreements which should be included in the lease and license database for monitoring.

RESPONSIBLE PARTY: Public Works.

COMPLETED BY: Online data entry forms will be reviewed and modified as necessary by the end of September, 2010.

2. Asset Management oversight of real property lease and licenses agreements is limited.

MANAGEMENT RESPONSE: Management agrees that Asset Management oversight of real property leases and licenses has been limited. The Asset Management staff has historically not exercised full responsibility for all "Real Property transactions such as buying, selling, leasing, licensing, and exchanges" as specified in the Procurement Code. Instead, several separate divisions have exercised leases and licenses for facilities or services within their functional areas with varying levels of support and involvement from the Asset Management staff. At the same time, Management recognizes that ongoing contract administration of lease and license agreements, as opposed to the procurement of the agreement, is often more efficiently performed by the sponsoring division.

PROPOSED RESOLUTION:

- Public Works Management will coordinate with management of other impacted divisions, most notable Community Services and Economic Vitality, to clearly identify transactions that require Asset Management staff involvement, and to identity which ongoing contract administration tasks are more appropriate for the sponsoring division.
- The City Code currently includes guidelines that direct competition for certain real property transactions, including leases and licenses. Public Works Management

Page 10 Audit Report No. 1008

will evaluate whether it would be beneficial to add dollar value thresholds to these criteria.

RESPONSIBLE PARTY: Public Works.

COMPLETED BY: Coordination with sponsoring departments regarding procurement of lease and license agreements and responsibility for ongoing administration tasks will be continuous effective immediately. Review and update, if necessary, of City Code requirements pertaining to public competition of leases and licenses will be completed by December, 2010.

3. Accounts receivable related to real property leases and licenses are not consistently recorded.

MANAGEMENT RESPONSE: Management agrees with this finding.

PROPOSED RESOLUTION: Accounting will continue to work with contract administrators to record unknown accounts receivable.

RESPONSIBLE PARTY: Accounts Receivable - Accounting.

COMPLETED BY: This will be an ongoing effort.

4. Maintaining two Citywide databases to record City contracts is inefficient.

MANAGEMENT RESPONSE: Management agrees that maintaining two separate and at least somewhat redundant databases may be inefficient.

PROPOSED RESOLUTION: Public Works management and Purchasing management will evaluate the need to maintain each of the individual databases. If each database will continue to be supported, Public Works and Purchasing will jointly evaluate the potential efficiency of combining the databases and proceed according to the evaluation.

RESPONSIBLE PARTY: Public Works and Purchasing.

COMPLETED BY: September, 2010.

City Auditor's Office

4021 N. 75th St., Suite 105 Scottsdale, Arizona 85251 (480) 312-7756 http://www.ScottsdaleAZ.gov Search: "auditor"

Audit Committee

Councilman Robert Littlefield, Chairman Vice Mayor Lisa Borowsky Councilwoman Suzanne Klapp

City Auditor's Office

Kyla Anderson, Senior Auditor Joyce Gilbride, Assistant City Auditor Lisa Gurtler, Assistant City Auditor Joanna Munar, Senior Auditor Lee Pettit, Senior Auditor Kim Prendergast, Senior Auditor Sharron Walker, City Auditor



The City Auditor's Office provides independent research, analysis, consultation, and educational services to promote operational efficiency, effectiveness, accountability, and integrity in response to City needs.